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Global supply chains and sustainability: the role of disclosure and due diligence laws

CHARLOTTE VILLIERS

1. Introduction

There is now considerable empirical evidence showing that income and wealth inequality can harm environmental sustainability.¹ Mikkelsen, Gonzalez and Peterson conclude that ‘a 1% increase in the Gini ratio is associated with an almost 2% rise in the number of threatened species’.² Dorling *et al* also show that rich countries with higher inequality consume more resources and generate more waste per person.³ Economic and social values may be reflected in actual government expenditure so that countries with higher scores on ‘economic individualism’ have lower levels of overall government spending per capita.⁴ Many such threats to sustainability, with increasing inequality, are compounded in the context of global supply chains. Indeed, according to Ernst and Young, companies ‘consistently recognize that they are less advanced in their supply chain sustainability efforts than their direct operations due to the complex nature of sustainability in their supply chain’.⁵

This chapter explores the role of corporations that participate in global supply chains and looks specifically at the legislation emerging to try to address the problems that arise in a supply chain context. There is a notable shift from voluntary initiatives towards hard law solutions, in particular disclosure and due diligence requirements. The argument I will pursue is that the disclosure measures introduced internationally and nationally only partially assist the efforts to achieve sustainability. Such measures are limited to achieve transparency, but they do not necessarily achieve progress in their substantive outcomes. Due diligence is more promising but to bring about the desired outcomes will require more active engagement with stakeholders, social movements and third parties. The next section will outline how global supply chains impact on sustainability and will describe the complexities of supply chains and the problems arising from such complex arrangements. Section 3 provides an overview of the disclosure provisions and highlights their limitations. Section 4 analyses

¹ J. K. Boyce, ‘Inequality as a cause of environmental degradation’ *Ecological Economics*, (1994) 11(3), 169-178; S. N. Islam, *Inequality and environmental sustainability* (2015, No. 145, 30) DESA Working Paper, at 1. See also T.M. Selden and D. Song, ‘Environmental quality and development: is there a Kuznets curve for air pollution emissions?’ *J. Environ. Econ. Manag.* (1994) 27, 147-162.

² G.M. Mikkelsen, A. Gonzalez, & G. D. Peterson, Economic Inequality Predicts Biodiversity Loss (2007) PLoS ONE, 2(5), e444. doi: 10.1371/journal.pone.0000444, at 2. The Gini coefficient is a measure of income inequality that condenses the entire income distribution for a country into a single number between 0 and 1: the higher the number, the greater the degree of income inequality. See further: Gini Coefficient of Inequality at https://www.statsdirect.com/help/nonparametric_methods/gini_coefficient.htm

³ D. Dorling *Is more equal more green?* (London: University of Sheffield, 2010); D. Dorling, ‘Social Inequality and Environmental Justice’ *Environmental Scientist*, (2010) 19(3), 9-13; D. Dorling, A. Barford, and B. Wheeler ‘Health Impacts of an environmental disaster: a polemic’, *Environmental Research Letters*, (2007) 2(045007), 11pp. doi:10.1088/1748-9326/2/4/045007 (www.worldmapper.org), cited by Islam, *Inequality and environmental sustainability*, at 4.

⁴ J. Haupt, J and C. Lawrence, ‘Unexpected connections: income inequality and environmental degradation’ 13 (February 2012), *Shaping Tomorrow’s World*, at <http://www.shapingtomorrowworld.org/hauptinequality.html>

⁵ Ernst and Young, *The state of sustainable supply chains: building responsible and resilient supply chains*, (2016), at 14.

the due diligence provisions and their potential to help reduce social and environmental harms. The chapter concludes by suggesting that further steps are required to build on the due disclosure measures if they are to fulfil such potential. In particular, their implementation requires joint participation of stakeholders, social movements and third parties. Without collective action, due diligence will amount to little more than a business dominated transparency machine that generates information without leading to substantive behavioural change.

2. Global supply chains and their impact on sustainability

Global supply chains⁶ (sometimes called global value chains or global production chains)⁷ are an established and widely used production arrangement across many industries, including manufacturing, energy, agri-food industry, and a myriad of financial and business services.⁸ The United Nations Conference on Trade Development (UNCTAD) suggested that global supply chains, shaped by transnational corporations, ‘account for some 80% of global trade’⁹ and the ILO has estimated that more than 450 million people work in supply chain-related jobs.¹⁰ Global supply chains have brought with them some benefits, such as employment and economic growth to developing economies and the possibility, at least in theory, of social upgrading.¹¹ However, global supply chains also bring costs. The European Parliament observes their benefits and their costs: they

‘offer new prospects for economic growth, sustainable development, the involvement of civil society, workers and business associations, and for job creation for companies within the production chain, by enabling them to focus on specific tasks while increasing their interdependence; whereas, on the other hand, their extremely complex nature, lack of transparency and dilution of liabilities may lead to a higher risk of human and labour rights violations, factual impunity for environmental crimes and large-scale tax avoidance and tax fraud.’¹²

The predominant feature of global supply chains is that of an ‘international fragmentation of production’.¹³ They have multiple tiers without being strictly linear and they have horizontal, vertical and spatial complexities – static and dynamic¹⁴ – that interact and lead to uncertainties and production

⁶ See also J. Salminen, ‘Sustainability and the Move from Corporate Governance to Governance Through Contract’, chapter 5 in this volume.

⁷ These are generally interchangeable terms. In this chapter I will mostly refer to them as global supply chains.

⁸ M. Rawling, ‘Legislative regulation of global value chains to protect workers: A preliminary Assessment’ 26(4) *The Economic and Labour Relations Review*, (2015) 660, at 663.

⁹ UNCTAD, World Investment Report (2013) iii. *WTO and Others, Global Value Chain Development Report 2017: Measuring and Analyzing the Impact of GVCs on Economic Development*, September 2017 at 2, available at https://www.wto.org/english/res_e/publications_e/gvcd_report_17_e.htm

¹⁰ International Labour Organization, ‘Forced labour, human trafficking and slavery’, undated, <http://www.ilo.org/global/topics/forced-labour/lang-en/index.htm>

¹¹ See discussion in L. Lee, *Global Supply Chain Dynamics and Labour Governance: Implications for Social Upgrading*, ILO Research Paper No. 14, (May 2016)

¹² European Parliament Motion for a Resolution 2016/2301 (INI) Report 20 July 2017, para C.

¹³ OECD, the World Trade Organisation (WTO) and the United Nations Conference on Trade and Development (UNCTAD) (2013) *Implications of Global Value Chains for Trade, Investment, Development and Jobs* 6 August 2013. *Prepared for the G-20 Leaders Summit*, Saint Petersburg, September, at 11.

¹⁴ S. Serdarasan, ‘A review of supply chain complexity drivers’, *Computers & Industrial Engineering*, (2013) 66(3), 533-540. See also S. Sarpong ‘Traceability and supply chain complexity: confronting the issues and concerns’, *European Business Review*, (2014) 26(3), 271-284.

disruptions,¹⁵ as well as regulatory challenges.¹⁶ The fragmented nature of the production processes leads many chains to require multiple layers of suppliers. Whilst companies may be able to locate their first-tier suppliers, the suppliers in the lower tiers are often less easy to identify.¹⁷ Sarfaty reveals that one company required more than a year to map its supply chain¹⁸, and quotes an employee of technology company Philips explaining that, “for electronic components, the supply chain can easily be 50 tiers deep, many of which may provide us with limited or no information”.¹⁹ In 2015, Apple had 785 suppliers in 31 countries worldwide contributing to the production of the iPhone.²⁰ According to the Business and Human Rights Resource Centre, 2017, up to 94 per cent of the global workforce of 50 major corporations is hidden because responsibility has been outsourced multiple times.²¹

This complexity gives opportunities for regulatory arbitrage, resulting in governance and regulatory gaps.²² Thus, while multinational companies might be incorporated and headquartered in a particular jurisdiction, many of their economic activities occur abroad in areas that are beyond the regulatory reach of their home jurisdiction. The potential regulatory problems arising from the extraterritorial reach of those activities are not necessarily resolved by the efforts of international or intergovernmental institutions because their regulatory capacities are limited.²³ Furthermore, the companies or suppliers may operate in developing countries which do not have sufficient resources or structures for effective regulation.²⁴ Host states may turn a blind eye to domestic law violations or shy away from passing human rights regulations, fearing that companies might shift their business elsewhere to avoid regulatory burdens.²⁵ Weak governance then paves the way for corruption and human rights violations,²⁶ with adverse consequences for sustainability.

According to Ernst and Young, UN Global Compact participants ‘rank supply chain practices as the biggest challenge to improving their sustainability performance.’ Thus, extending the UN Global Compact’s Ten Principles into the supply chain can be difficult ‘because of the scale and complexity of many supply chains.’²⁷ They are often coordinated by powerful, multinational lead firms that source quality goods and services at the lowest cost and thus through their own profit seeking behaviour they exploit the workers at the bottom of their chains.²⁸ Global supply chains have potential to undermine the goal of sustainability – weak or strong – in many ways and across all dimensions. Lead firms

¹⁵ C. Bode and S.M. Wagner, ‘Structural drivers of upstream supply chain complexity and the frequency of supply chain disruptions’, *Journal of Operations Management*, (2015) 36, 215-228.

¹⁶ See eg Jingchen Zhao, ‘A critical analysis of extraterritorial attempts at addressing challenges to sustainability’ chapter 3 in this volume.

¹⁷ G. A. Sarfaty, ‘Shining light on global supply chains’, *Harv. Int’l LJ*, (2015) 56, 419, at 431.

¹⁸ Shift Project, *Respecting Human Rights through Global Supply Chains*, 7 (2012) cited by Sarfaty, ‘Shining Light’, fn 78, at 431.

¹⁹ *Ibid.*

²⁰ J. G. Ruggie, ‘Multinationals as global institutions: Power, authority and relative autonomy’ *Regulation and Governance* (2017) at 3.

²¹ Business & Human Rights Resource Centre (BHRCC), *Modern slavery in company operations and supply chains: mandatory transparency, mandatory due diligence and public procurement due diligence*, (September 2017).

²² Sarfaty, ‘Shining light’, 433. See further Zhao, chapter 3 in this volume.

²³ *Ibid.*

²⁴ K. Kolben, ‘Transnational labor regulation and the limits of governance’, *Theoretical Inquiries in Law* 12.2 (2011): 403-437, at 406.

²⁵ A. S. Chilton, and G. A. Sarfaty, The Limitations of Supply Chain Disclosure Regimes. *Stan. J. Int’l L.*, (2017) 53, 1, at 8, citing S. R. Ratner, *Corporations and Human Rights: A Theory of Legal Responsibility*, 111 Yale L.J. (2001) 443, at 460 and 463.

²⁶ Ruggie, ‘Multinationals as global institutions’, at 8, citing OECD, *Risk Awareness Tool For Multinational Enterprises In Weak Governance Zones* (2006).

²⁷ Ernst and Young, *The State of Sustainable Supply Chains* (2016) at 2.

²⁸ Rawling, ‘Legislative regulation of global supply chains’ at 661.

operate by externalising the responsibilities for the production process and for how the workers are treated. At the same time, they impose their powerful position to keep the production costs low and to maximise their profits.²⁹ The supplier is then left with little choice but to cut its own production costs and to pass those on by paying lower wages to the workers and leaving them to work in unsafe production facilities with few labour law rights or protections. The end result is employment with deleterious effects upon workers, including poverty pay and unfree labour.³⁰ Human Rights Watch, for example, documents poor working conditions, including minimum wage violations; forced overtime; child labour; sexual harassment, exposure to toxic substances and other extreme occupational hazards; and retaliation against workers who attempt to organize.³¹ Global supply chains also operate in ways that may cause environmental damage such as through mining, deforestation, pollution, and carbon footprint. The UN Global Compact Office and the Business for Social Responsibility organization, in the second edition of their document *Supply Chain Sustainability: A Practical Guide for Continuous Improvement*, observe that 'environmental impacts from supply chains are often severe, and might include toxic waste, water pollution, loss of biodiversity, deforestation, long term damage to ecosystems, water scarcity, hazardous air emissions as well as high greenhouse gas emissions and energy use.'³² Frequently linked to 'exploitative employment relations, environmental irresponsibility and recurrent ethical dilemmas', they contribute to global poverty and wealth and income inequality, a 'risk that is most likely to cause serious damage globally'.³³

3. International and national disclosure requirements

Recognising these problems, a number of international organisations have sought to guide corporate behaviour with the introduction of standards and principles. National legislatures have acted to supplement those international efforts. This section explores these measures which are put into practice through use of disclosure requirements.

3.1 International measures

In June 2011, the United Nations Human Rights Council (UN HRC) unanimously endorsed the UN Guiding Principles on Business and Human Rights (UNGPs).³⁴ These became the first globally accepted standard on the responsibilities of states and businesses for preventing and addressing business-related human rights abuse. The principles are based on the UN 'Protect, Respect and Remedy' Framework, approved in 2008. The 31 UNGPs require that businesses should respect human rights. In particular, Principle 13 states that business should 'avoid causing or contributing to adverse human

²⁹ T. Clarke and M. Boersma, 'The governance of global value chains: Unresolved human rights, environmental and ethical dilemmas in the apple supply chain', *Journal of Business Ethics*, (2017) 143(1), 111-131, at 115-6.

³⁰ B. Selwyn, *Global Value Chains or Global Poverty Chains? A new research agenda*, (2016) available at <https://www.sussex.ac.uk/webteam/gateway/file.php?name=selwyn-global-chains-2016-w-imprint.pdf&site=359> at 5.

³¹ Human Rights Watch, *Human Rights in Supply Chains: A Call for a Binding Global Standard on Due Diligence*, (May 2016) available at: <https://www.hrw.org/report/2016/05/30/human-rights-supply-chains/call-binding-global-standard-due-diligence>

³² UN Global Compact Office and BSR, *Supply Chain Sustainability: A Practical Guide for Continuous Improvement* (2nd edition, 2015) at 9.

³³ D. Tapscott, 'Davos Group Sees Income Inequality as Top Global Risk' Huffington Post, 21 January 2014, at https://www.huffingtonpost.com/don-tapscott/davos-group-sees-income-i_b_4639340.html See also World Economic Forum, *Global Risks 2014, Ninth Edition*, (WEF, Geneva, 2014) at http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2014.pdf

³⁴ UN Guiding Principles on Business and Human Rights, 2011, http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

rights impacts through their own activities, and address such impacts when they occur'³⁵ and 'seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts'³⁶. Principle 15(a) stipulates that businesses should have in place a policy commitment to meet their responsibility to respect human rights. In addition, the UN Global Compact encourages businesses to adopt sustainable and socially responsible policies and lays down ten principles in the areas of human rights, labour, the environment and anti-corruption.

Other organizations have taken steps to strengthen the impact of the UN's efforts. The OECD has developed in its Guidelines for Multinational Enterprises, a set of recommendations addressed by governments to multinational enterprises. They were revised in 2011 to take into account the UNGPs and the revisions introduced standards on human rights, due diligence and supply chain responsibility. Whilst they are non-binding, the Guidelines have a hybrid status requiring National Contact Points to further their effect.³⁷

At European level the Non-Financial Reporting Directive has become the instrument used for introducing a requirement for certain large undertakings (public interest entities) to include in their management reports a non-financial statement containing information relating to environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. The Directive references at paragraph 9 the UNGPs and the OECD Guidelines as regimes that companies might adhere to in their provision of the relevant non-financial information. The statement should include a description of the policies, outcomes and risks related to those matters and information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts.³⁸ The statement might include information on the prevention of human rights abuses and on measures taken to prevent bribery or corruption.³⁹

3.2 National Measures

For disclosure-oriented transparency the most widely publicised developments include the California Transparency in Supply Chains Act 2010 and the UK's Modern Slavery Act 2015.

The California Transparency in Supply Chains Act 2010 requires website disclosure of any actions being taken to eradicate slavery and human trafficking from a corporation's direct supply chain for tangible goods offered for sale. The company must disclose on its website 'to what extent, if any,' it: 1) verifies its product supply chains to evaluate and address risks of human trafficking and slavery; 2) audits its suppliers to evaluate their compliance with company standards for human trafficking and slavery; 3) requires certifications from direct suppliers confirming that materials incorporated into the products comply with laws regarding human trafficking and slavery in the countries in which the suppliers operate; 4) maintains internal accountability through internal standards and procedures for employees and contractors that fail to meet company standards regarding human trafficking and slavery; and 5) trains company employees and management who have direct responsibility for supply

³⁵ Principle 13(a).

³⁶ Principle 13(b).

³⁷ S. van't Foort, 'The History of National Contact Points and the OECD Guidelines for Multinational Enterprises.' (2017) at https://transparencia.org.es/wp-content/uploads/2017/09/puntos_nacionales_contacto_directrices_ocde.pdf

³⁸ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1–9, Preamble, paragraph 6.

³⁹ See also Article 1(1) and 1(3).

chain management on human trafficking and slavery.⁴⁰ A company may comply with the law by posting only one statement ever, since the Act does not specify how frequently a statement must be made.⁴¹ The California Attorney General has exclusive authority to enforce the legislation leading a civil action for injunctive relief. By 2015, the Attorney General had not used this power of enforcement.⁴² Companies do not face a monetary penalty for failure to disclose, but the Attorney General may order them to take specific action. Citizens have no private right of action under the Act although there is evidence of private litigants using class action-friendly California statutes, such as the Unfair Competition Law and False Advertising Law, to bring class actions in which they may allege violations of the Transparency legislation.⁴³ A Federal US Business Transparency in Trafficking and Slavery Bill targets all businesses with revenues above US\$100 million and if enacted will require them to describe in their annual reports how they assess and address slavery in their supply chains.⁴⁴

In the UK, section 54 of the Modern Slavery Act 2015 requires any commercial organisation, which supplies goods or services, carries on a business or part of a business in the UK, and whose annual turnover is £36 m to produce a slavery and human trafficking statement for each financial year. The report must provide details of what the organisation is doing to 'ensure that slavery and human trafficking is not taking place in any of its supply chains, and in any part of its own business.' Section 54 contains a non-exhaustive list of the issues that the statement 'may' cover, including: the organisation's structure, its business and its supply chains; its policies in relation to slavery and human trafficking; its due diligence processes in relation to slavery and human trafficking in its business and supply chains; the parts of its business and supply chains where there is a risk of slavery and human trafficking taking place, and the steps it has taken to assess and manage that risk; its effectiveness in ensuring that slavery and human trafficking is not taking place in its business or supply chains, measured against such performance indicators; and the training and capacity building about slavery and human trafficking available to its staff. If a company fails to produce a slavery and human trafficking statement for a particular financial year the UK Secretary of State may seek an injunction from the High Court requiring the organisation to comply. Some have suggested that this would be 'an unlikely course of action.'⁴⁵ In such an event, failure to comply with the injunction would put the company in contempt of a court order, which is punishable by an unlimited fine.

Commentators have remarked on the weaknesses in both the California Act and the UK Act stating that

neither law requires that companies report on the prevalence or known incidences of modern slavery in their operations or supply chains, nor do they include any positive obligation for a company to implement measures or introduce any policies or operational changes to ensure that their operations and supply chains are free from slavery. In fact, under both laws companies can comply by stating they have taken no steps to address the risk of modern slavery in any form in their business and supply chain.⁴⁶

⁴⁰ BHRRC (2017) at 8.

⁴¹ Ibid.

⁴² See Mintz Viewpoint, 'When Transparency Is Not Enough: Class Action Litigation Under California's Transparency in Supply Chains Act', 12 November 2015, at <https://www.mintz.com/insights-center/viewpoints/2015-11-when-transparency-not-enough-class-action-litigation-under>

⁴³ Ibid.

⁴⁴ HR 3226, 114th Congress (2015-16)., referred to the House Committee on Financial Actions. See further: BHRRC (2017) at 8.

⁴⁵ S. Shooter, *The Modern Slavery Act: An Update*, Bird & Bird, (12 September 2017), available at <https://www.twobirds.com/en/news/articles/2017/uk/the-modern-slavery-act-update>

⁴⁶ BHRRC, *Modern slavery in company operations*, at 10.

Furthermore, lack of statutory sanctions will do little to encourage companies to report or to implement robust due diligence processes.⁴⁷ Due diligence processes are not compulsory, nor is reporting on them under these statutes. More positively, perhaps, the Modern Slavery Act could lead indirectly to enforcement via companies seeking to avoid the commercial risk of reputational damage and adverse public reaction. NGOs might also be persuaded to monitor the extent of compliance with the disclosure provisions and in turn push for more substantive action. In California, for example, a class action was raised against Costco, alleging that Costco's statement misled consumers by implying its products were 'slavery free'.⁴⁸

The results of the Modern Slavery Act have been modest so far. The Act has not led to full and effective disclosure by corporations. In 2016, the Business & Human Rights Resource Centre found that only 15 of 27 statements analysed (56 per cent) complied with the minimum requirements. Their analysis showed 'patchy compliance with the substantive provisions of the Act'.⁴⁹ Only a small number of the 27 FTSE 100 companies analysed provided information on risks they identified in their operations and supply chains and explained how they addressed them. Most companies provided little information on the structure and complexity of their supply chains, and very few provided information on specific risks in those chains. Only two companies reported developing performance indicators.⁵⁰ A subsequent briefing released in June 2017 by CORE Coalition revealed that only around 14 per cent out of over 2,100 statements under the MSA comply with the minimum requirements and most of those provide little information on the six areas the Act suggests companies to report on.⁵¹ According to a 2016 review of 230 MSA company statements conducted by Ergon Associates, most fail to comply with minimum requirements; 40 per cent had not been signed by a director, and about 30 per cent were not accessible via a link easily found on the company's web-site.⁵² Ergon's review also noted poor reporting on key performance indicators, and that 35 per cent of statements 'say nothing on the question of their risk assessment processes'.⁵³

*3.3 Evaluation of the disclosure measures*⁵⁴

Disclosure regulation is based on an 'assumption that information matters and information can empower'.⁵⁵ However, such empowerment depends on information that is valuable, accessible,

⁴⁷ Ibid, at 11.

⁴⁸ Freshfields Bruckhaus Deringer, Section 54 of the Modern Slavery Act – transparency in supply chains, 29 October 2015, at http://knowledge.freshfields.com/en/global/r/1314/section_54_of_the_modern_slavery_act_transparency_in

⁴⁹ BHRRC, 'Modern slavery in company operations', at 13.

⁵⁰ Ibid. at 13.

⁵¹ CORE, *Modern Slavery reporting: Weak and Notable Practice*, (June 2017), at http://corporate-responsibility.org/wp-content/uploads/2017/06/Core_ExamplesFINAL.pdf

⁵² Ergon Associates, *Reporting on Modern Slavery: The Current State of Disclosure*, May 2016, at <http://ergonassociates.net/wp-content/uploads/2017/06/Reporting-on-Modern-Slavery2-May-2016.pdf?x74739>. See also Ergon Associates, *Modern Slavery Statements: One Year On*, April 2017, at http://ergonassociates.net/wp-content/uploads/2016/03/MSA_One_year_on_April_2017.pdf?x74739

⁵³ Ibid.

⁵⁴ See further, Iris Chiu, 'Disclosure Regulation in Corporate Social Responsibility- (New) Legalisation and New Governance Implications', chapter 27 in this volume.

⁵⁵ A. Gupta, *Transparency Under Scrutiny: Information Disclosure in Global Environmental Governance* (2008) 8:2 *Global Environmental Politics*, at 2 quoting Florini, Ann.1998. *The End of Secrecy. Foreign Policy* 111 (Summer): 50–63 at 3.

comprehensible and comparable.⁵⁶ Yet difficulties stand in the way of effective and empowering disclosure regulation, including: proliferation of measures that may compete or contradict each other, commodification of information, power reinforcement, information overload with consequent lack of enforcement or remediation.

3.3.1 Proliferation of measures

The multiplicity of measures contributes to inconsistencies and lack of coherence. This has been the experience in environmental reporting where multiple frameworks, and tension between the corporate and stakeholder objectives in transparency have 'produced a number of governance systems that might be applied simultaneously and to different effect and for different constituencies.'⁵⁷ As Backer observes, 'In the aggregate, these transparency systems are incoherent, making miscommunication likely and assessment across systems difficult.'⁵⁸

3.3.2 Marketization

Emphasis on business case arguments for disclosure causes the processes to be a means for corporations to secure market leadership⁵⁹ rather than really to reduce the problems that their activities bring about. Disclosure has indeed become increasingly marketized or commodified.⁶⁰ Disclosure systems more often compete and are shaped by investor and consumer tastes rather than by science and policy.⁶¹ New intermediaries/powerbrokers facilitate, translate, certify, interpret and articulate information in order to make it available and useful for different categories inside and outside value chains and networks.⁶² Environmental NGOs gain advantage too as they seek financial compensation for their logos and endorsements designed to enhance reputation, trust and legitimacy for the companies who use them.⁶³

3.3.3 Power

In supply chains lead companies seize power over the actors further down the supply chain not just in their production processes but also in disclosures made⁶⁴ by coordinating and enforcing agreements, transmitting environmental and human rights norms, and also by conducting due diligence along their supply chains.⁶⁵ They are able to manage and control the information flow and to pin blame on

⁵⁶ K. Dingwerth and M. Eichinger, 'Tamed transparency: How information disclosure under the Global Reporting Initiative fails to empower', *Global Environmental Politics* 10.3 (2010): 74-96, at 75, citing A. Fung, et al, *Full Disclosure. The Perils and Promise of Transparency* (Cambridge: Cambridge University Press, 2007).

⁵⁷ L. C. Backer, 'Transparency between norm, technique and property in international law and governance: The example of corporate disclosure regimes and environmental impacts.' *Minn. J. Int'l L.* 22 (2013): 1, at 48.

⁵⁸ Ibid, 49-50. See also Villiers, C & Mahonen, J, 2015, 'Article 11: Integrated reporting or non-financial reporting?'. in: Beate Sjafjell, Anja Wiesbrock (eds) *The Greening of European Business under EU Law: Taking Article 11 TFEU Seriously*. (Routledge), pp. 118-143; and Villiers, C & Mahonen, J, 2015, 'Accounting, auditing and reporting: supporting or obstructing the sustainable companies objective?'. in: Beate Sjafjell, Benjamin J Richardson (eds) *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, Cambridge), pp. 175-225

⁵⁹ Dingwerth and Eichinger, at 80.

⁶⁰ Backer, 66.

⁶¹ Backer, 70.

⁶² A. Mol, 'Transparency and value chain sustainability', *Journal of Cleaner Production*, (2015) 107, 154-161 at 155.

⁶³ Mol, 2010, at 139.

⁶⁴ Mol (2015) at 157.

⁶⁵ Sarfaty, 'Shining a light' at 432.

suppliers for information.⁶⁶ Sometimes, however, the suppliers gain power over the buyer firms when the buyer or lead firm is unable to switch to another supplier or lacks purchasing power. Then, the lead firm may be forced to tolerate non-compliant and opportunistic behaviour by (perhaps geographically distant) suppliers.⁶⁷

3.3.4 The recipients of information

The information provided is not always useful or relevant in practice and does not necessarily meet the needs of the recipients. For example, consumers might not be able to discover the extent of human rights abuses in supply chains nor to identify which companies are making comprehensive efforts to protect human rights and which are not.⁶⁸ Consumers may be further disempowered⁶⁹ by information overload or 'data fog'⁷⁰, being swamped by too many, or too technically complex, disclosures.⁷¹ Thus, Cooper and Owen reveal that corporate disclosures offer little opportunity for facilitating action on the part of organizational stakeholders and therefore do not give rise to accountability.⁷²

4. Due Diligence

In light of these problems and the apparent limitations of the disclosure legislation, there have been calls to take steps towards due diligence. For example, the UK Joint Committee on Human Rights has recommended the UK government to propose legislation to make reporting on due diligence for all human rights compulsory for large businesses, with a monitoring mechanism and an enforcement procedure, and the strengthening of the UK National Contact Point. At the international level also, due diligence has been advocated as a process with potential for progress. The UN Guiding Principle 15(b), for example, in urging businesses to respect human rights, proposes that they adopt a human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights. Similarly, the OECD has issued additional Guidance documents such as the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas in 2011, the third edition of which was published in 2016, and also the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sectors in 2017, and most recently, the OECD Due Diligence Guidance for Responsible Business Conduct, of May 2018 which aims to provide guidance to enterprises on their implementation of the OECD's Guidelines for Multinational Enterprises 2011. Human Rights Watch has argued for the OECD's Guidance documents to become binding rather than voluntary.⁷³

4.1 What is due diligence?

⁶⁶ Backer, at 47.

⁶⁷ Sarfaty, 'Shining a light' at 433.

⁶⁸ Chilton and Sarfaty, 'Limitations of Supply Chain Disclosure Regimes' (2017) at 46.

⁶⁹ Mol, 2015, 158.

⁷⁰ D. Shenk, *Data Smog. Surviving the Information Glut*. (Harper Collins, New York, 1997). cited by Mol, (2015) at 158.

⁷¹ Chilton and Sarfaty, (2107) at 22.

⁷² S. M. Cooper and D. L. Owen, 'Corporate social reporting and stakeholder accountability: The missing link' *Accounting, Organizations and Society*, (2007) 32(7), 649-667.

⁷³ Human Rights Watch note that the Guidance has become part of the legal framework in a number of African countries, including the DRC, Burundi and Rwanda where sanctions are included for failure to comply (OECD, A Global Standard: Towards responsible mineral supply chains, available at https://mneguidelines.oecd.org/Brochure_OECD-Responsible-Mineral-Supply-Chains.pdf).

Due diligence goes beyond simply making statements about the risks of human rights abuses or environmental damage and what policies a company has in place within its supply chain to avoid those risks or to measure its impacts. Due diligence requires companies to demonstrate that they are taking measures to prevent or mitigate their negative impacts.⁷⁴ The UN and the OECD focus on identification of risks and requiring companies then to seek to eradicate those risks and to account for any adverse impacts that do occur. Thus, due diligence is defined by the UN and the OECD as a risk-based process ‘through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts’.

The OECD Guidance documents highlight a five-step framework, which includes: 1, establishing strong company management systems; 2, identifying and assessing risks in the supply chain; 3, designing and implementing a strategy to respond to identified risks; 4, carrying out independent third party audit of supply chain due diligence; and 5, reporting annually on supply chain due diligence. Companies must assess actual and potential human rights impacts, integrate and act upon the findings, track responses and communicate how impacts are addressed.⁷⁵ The OECD Guidance on Due Diligence for Responsible Business Conduct has developed these five steps into a six-step framework, recommending 1) embedding responsible business conduct into policies and management systems; 2) identifying and assessing adverse impacts in operations, supply chains and business relationships; 3) ceasing, preventing or mitigating adverse impacts; 4) tracking implementation and results; 5) communicating how impacts are addressed; and 6) providing for or cooperating in mediation when appropriate.⁷⁶

The OECD, together with input from the ILO, the IMF and the World Bank Group, has also published a guidance note to promote the sustainable development goals and to advise on due diligence requirements.⁷⁷ These, as well as the 2018 Guidance on Responsible Business Conduct, include guidance on development and publication of a responsible business conduct policy to be integrated and embedded into a company’s management systems and activities and in its contracts with suppliers. Companies should regularly identify and assess any impacts adversely affecting their responsible business conduct and they should prevent or mitigate such impacts and track their performance. They should communicate with and account to stakeholders and they should seek to remedy any adverse impacts.⁷⁸ The Ethical Trading Initiative has added its own guidance suggesting that the key features of due diligence include corporate leadership; establishing and revising appropriate policies, practices, strategies and decision-making systems that mitigate against the risks of labour rights abuses; increased transparency and visibility of supply chains; acceptance and recognition of the universal right of all workers to freedom of association and collective bargaining; commitment to ensuring remedy for negative impacts on workers; recognition of the importance of policy engagement with governments and other key stakeholders for greater state protection of workers’ rights; stakeholder engagement and partnerships; continuous improvement based on robust evidence, monitoring, and evaluation; and open and honest communication within the company, and with suppliers, stakeholders and workers and to the public.⁷⁹

⁷⁴ BHRRC, at 4.

⁷⁵ OECD Guidance on MNEs, Chapter IV, para 45.

⁷⁶ OECD Due Diligence Guidance for Responsible Business Conduct 2018, 21-35.

⁷⁷ OECD, ILO, IMF, World Bank Group, *Promoting Sustainable Global Supply Chains: International Standards, Due Diligence And Grievance Mechanisms*, (February 2017), available at http://www.ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---ilo-berlin/documents/genericdocument/wcms_556985.pdf

⁷⁸ Ibid, at 19.

⁷⁹ Ethical Trading Initiative, Human Rights Due Diligence Framework, May 2016, available at <https://www.ethicaltrade.org/resources/human-rights-due-diligence-framework>

Overall, we can see that due diligence goes much further than disclosure. It includes action to protect against and mitigate adverse impacts of a corporation's or supply chain's activities. These international initiatives have inspired regional and national due diligence measures.

4.1.2 EU

At EU level, as well as the EU's Non-Financial Reporting Directive, an EU Regulation 2017/821⁸⁰ was introduced, applicable since January 2017, which establishes obligations related to management systems, risk management, and independent third party audits for importers of conflict minerals. Such importers must prepare annual reports on the steps taken to implement those obligations as well as their supply chain due diligence policies and practices for responsible sourcing, and they must make available to their governments third party audit reports or evidence of conformity with a supply chain due diligence scheme.

The European Parliament has introduced a 'flagship initiative' calling for similar due diligence requirements in the garment sector.⁸¹ In addition, an EU green card initiative proposes that EU-based companies operate under a duty of care towards individuals and local communities whose human rights or local environment are affected by corporate activities and Motion 2015/2589 requests the European Council to consider new EU legislation to create a legal obligation of due diligence for EU companies outsourcing to third countries, including measures to secure traceability and transparency. The European Parliament also passed a resolution in September 2017 based on a further motion – 2016/2301 (INI) – for a resolution on the impact of international trade and the EU's trade policies on global value chains which, among other things, calls on the Commission to work on the development of due diligence requirements.

4.1.2 France⁸²

France recently introduced Law 2017-399 on the corporate duty of care for parent and subcontracting companies. In addition to their reporting obligations, companies must actually implement a due diligence plan and undertake 'reasonable vigilance' to make sure the plan is implemented. This '*plan de vigilance*' will describe the company's oversight mechanisms for identifying and mitigating any violations of human rights and fundamental freedoms, severe bodily or environmental damage or health risks resulting from the company's activities or the activities of companies it controls or any of its subcontractors or suppliers. Companies must disclose their due diligence plan annually.⁸³ The French law does not require that slavery or trafficking are eradicated, but that companies engage in oversight.⁸⁴ The French law specifies the contents of the due diligence plan, including: risk mapping to identify, analyse and prioritise risks; processes for regular evaluation of subsidiaries, subcontractors and suppliers; appropriate actions to mitigate and prevent human rights and environmental violations; alert and whistleblowing mechanisms related to existing and potential risks; and mechanisms for monitoring and assessing the effectiveness of the measures implemented.

⁸⁰ Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas – see further chapter in this book by Iris Chiu.

⁸¹ Resolution of 27 April 2017 on the EU flagship initiative on the garment sector, 2016/2140(INI), leading to the publication by the European Commission of a Commission Staff Working Document: Sustainable garment value chains through EU development action SWD (2017) 147.

⁸² See further, Veronique Magnier, 'Corporate Law, Corporate Governance and Sustainability in France: An innovative old-fashioned model of governance', chapter 20 in this volume.

⁸³ BHRRC, at 17.

⁸⁴ J. Martin, 'Hiding in the Light: The Misuse of Disclosure to Advance the Business and Human Rights Agenda', available at www.ssrn.com at 25.

4.1.3 The Netherlands

The Netherlands is currently in the process of legislating for a duty of care to prevent child labour – the “Wet zorgplicht kinderarbeid”. Under this legislation, companies selling or delivering products or services to Dutch end users will be required to investigate and identify whether there is a reasonable suspicion that child labour is contributing to their delivering or selling of goods or services in their chain. If such a suspicion arises, a company must develop a plan of action to address it and issue a due diligence statement. A supervising authority will be appointed to monitor compliance with the Bill. The statement will be recorded in a public register, which will also be held by the supervising authority, thought likely to be the Dutch Authority on Consumers and Markets.⁸⁵ Any stakeholder who has clear evidence that a company has used child labour to produce goods or services may submit a complaint to that company. If the company does not resolve the complaint satisfactorily with the stakeholder within six months, the stakeholder will then be able to submit the complaint to Dutch authorities, who may issue a legally-binding instruction ordering the company to conduct the required due diligence and make the appropriate declaration. A failure by the company to comply with the instruction will result in a fine of up to EUR 820,000 or, alternatively, 10% of their annual turnover and two or more failures within five years may lead to criminal penalties and more substantial fines. The companies covered by the legislation include not only companies that are registered with the Dutch trade register but also foreign companies if they deliver goods or services to end-users in the Netherlands more than once a year.⁸⁶ At the time of writing, the law awaits approval by the Dutch Senate.

4.1.4 Switzerland

Switzerland is also working towards a potential article 101(a) on the Responsibility of Business in the Federal Constitution with the goal of obliging Swiss companies to incorporate respect for human rights and the environment in all their activities. The First Chamber of the Parliament approved the proposal in June 2018 and a counterproposal is awaiting consideration in the parliament’s Second Chamber.⁸⁷ If enacted, this new Constitutional provision will have extraterritorial effect by applying also to Swiss-based companies’ activities abroad. Under the proposal, companies will be required to carry out appropriate due diligence. Companies will also be liable for damage caused by companies under their control where they have, in the course of business, committed violations of internationally recognized human rights or international environmental standards. They will not be liable, however, if they can prove that they took all due care to avoid the loss or damage, or that the damage would have occurred even if all due care had been taken.⁸⁸ This Responsible Business Initiative is a popular initiative brought by a coalition led by NGOs, including Greenpeace and Amnesty International, and is supported by 85 organisations working in international aid, women and human rights and environmental protection, as well as churches, unions and shareholders’ associations. In Switzerland, most popular initiatives do not achieve the required formal approval to become law, but even if unsuccessful, a popular initiative may still shape the political landscape by generating public debate, highlighting specific issues and putting pressure on politicians.⁸⁹ The Swiss proposed law, if adopted, would require companies to

⁸⁵ Stibbe, Bill adopted by Dutch Parliament introducing a duty of care to prevent child labour, 22 May 2017, at <https://www.stibbe.com/en/news/2017/may/bill-adopted-by-dutch-parliament-introducing-a-duty-of-care-to-prevent-child-labour>

⁸⁶ Ibid.

⁸⁷ See European Coalition for Corporate Justice, Evidence for Mandatory HRDD legislation, Background Note, September 2018, at <http://corporatejustice.org/policy-evidence-mhrdd-september-2018-final.pdf>

⁸⁸ Swiss Coalition for Corporate Justice, English Translation of the Initiative Text, available at <http://konzern-initiative.ch/wp-content/uploads/2017/11/The-initiative-text-with-explanations.pdf>

⁸⁹ J. Hughes-Jennett, P. Hood, and M. Davoise, *Switzerland: The next frontier for mandatory human rights due diligence?* Hogan Lovell, (1 December 2017), available at

identify real and potential impacts on internationally recognized human rights and the environment; take appropriate measures to prevent the violation of internationally recognized human rights and international environmental standards, cease existing violations, and account for the actions taken. On the 14th June, the Swiss National Council approved a counter-proposal which establishes human rights obligations for Swiss companies with respect to their overseas impacts, as well as civil liability for parent companies for the harm caused by entities under their control. As a compromise, the counter-proposal is not as far reaching as the Responsible Business Initiative in that it applies to large companies and the civil liability provisions are more restrictive. If this counter-proposal is accepted by the Council of State and adopted the Responsible Business Initiative will be withdrawn.⁹⁰

4.2 Evaluation of due diligence

Due diligence demands an active evaluation and assessment so that, if it is clear that a company's processes are having or are likely to have negative impacts, then such companies must show what steps they have taken to remove or mitigate those negative impacts. The international soft law and developing national legislative requirements in their detail indicate at least a potential for companies to be much more rigorous and proactive about what they are looking for in a due diligence process compared with mere disclosure, which does not necessarily require a company actively to investigate their processes deeply for assessing their impacts. If impacts come to light then disclosure provisions would require companies to reveal those impacts in their statements as well as to reveal publicly what their policies are to deal with potential impacts.

Many of these provisions are not yet in a state of maturity. The EU provisions, for example, are limited to audits to demonstrate if due diligence processes have been developed or are Parliamentary Resolutions or Motions that have not yet resulted in concrete measures. The French law is still too recent for us to draw conclusions on its effectiveness and indicates no guarantee of prevention of human rights violations but rather that companies make efforts to eradicate or reduce those risks and be able to demonstrate those efforts. The Netherlands and Swiss efforts are still being developed and debated. Their provisions indicate at least a potential for greater effectiveness than the less radical disclosure requirements.

The guidance documents published by the OECD and the ETI confirm that due diligence is not a process to be carried out in isolation from those who have a stake in their outcomes but requires communication with and involvement of stakeholders. The 2018 OECD guidance document provides detailed recommendations designed to help enterprises to implement a due diligence process and supporting measures to avoid and address adverse impacts that may be associated with their operations, supply chains and other business relationships. The document highlights the key features of due diligence: its purpose is to prevent adverse impacts, or where such adverse impacts cannot be avoided, to enable enterprises to mitigate them, prevent their recurrence and, where relevant, remediate them; that due diligence involves a bundle of interrelated processes to identify adverse impacts, prevent and mitigate them, track implementation and results and communicate on how adverse impacts are addressed; it is risk-based and can be prioritised in accordance with the risk severity and likelihood; that due diligence is a dynamic process with feedback loops; it does not shift liabilities; it is adaptable to an enterprise's circumstances and limitations; it is concerned with

<https://www.hlregulation.com/2017/12/01/switzerland-the-next-frontier-for-mandatory-human-rights-due-diligence/>

⁹⁰ Swiss Coalition for Corporate Justice, Another step towards the adoption of a mandatory HRDD bill in Switzerland, 16 June 2018, at <http://corporatejustice.org/news/7046-another-step-towards-the-adoption-of-a-mandatory-hrdd-bill-in-switzerland>

internationally recognised standards of responsible business conduct; it is informed by stakeholder engagement and involves ongoing communication.⁹¹

Stakeholder engagement is arguably the key to effective due diligence. Indeed, it should play a pivotal role not least because, as the OECD Guidance stresses, due diligence is not about the business enterprise or the risks to the business but is about the people who are affected by its activities. Those people are relevant to the due diligence process and may make valuable contributions to the quality and effectiveness of the due diligence. Therefore, meaningful stakeholder engagement is a key component of due diligence.⁹² Indeed, commentators point out that effective approaches to human rights issues in global supply chains are characterised by companies engaging with a broad range of stakeholders. This requires them to take ‘a contextual and holistic approach by considering local circumstances and broader human rights, and by focusing on prevention and remediation.’⁹³ Thus, by reducing information asymmetries, disclosure may enable weaker parties to participate more effectively and hold the corporate actors to account more easily.⁹⁴ The shift towards stakeholder collaboration and due diligence may lead companies to adopt proactive and pluralistic strategies.⁹⁵

The challenge in the supply chain context, given the complexities of the supply chains, will be how to ensure that the stakeholders may participate effectively in the due diligence process. The OECD Guidelines of 2018 provide details about the what might be required for effective stakeholder engagement, telling us that stakeholder engagement involves interactive processes of engagement through, for example, meetings, hearings or consultation proceedings and that ‘meaningful stakeholder engagement is characterised by two-way communication and depends on the good faith of the participants’ as well as being responsive and on-going.⁹⁶ Multi-stakeholder partnerships, and collaborations between corporations and civil society organisations such as NGOs, religious organisations and trade unions remain important⁹⁷ as does the external threat of reputational damage strategies by those organisations. As Boersma suggests, ‘in adopting collaborative and pluralistic strategies and building on existing stakeholder expertise, companies can play a transformative role in the sectors and regions in which they operate.’⁹⁸ Boersma emphasises in this respect a ‘shift from reactive and paternalistic tendencies of companies towards proactive and pluralistic strategies’⁹⁹ that include, rather than exclude shareholders. If stakeholders come to be regarded as welcome members of the supply chain rather than as excluded adversaries the result might be safer, more sustainable and human rights respecting business enterprises.

5. Conclusion

This chapter has identified a shift towards both disclosure and due diligence requirements in the regulation of corporations and their global supply chains. Existing soft law provisions may not have had any material impact on corporate activity but they provide a useful basis upon which some

⁹¹ OECD, *Due Diligence Guidance for Responsible Business Conduct* (2018) at 16-19.

⁹² Ibid, at 50. See also OECD, Blog: the new OECD Due Diligence Guidance on Responsible Business Conduct OECD Watch 20 June 2018, at <https://www.oecdwatch.org/news-en/blog-the-new-oecd-due-diligence-guidance-on-responsible-business-conduct>

⁹³ M. Boersma, ‘Changing approaches to child labour in global supply chains: Exploring the influence of multi-stakeholder partnerships and the united nations guiding principles on business and human rights’, *UNSWLJ*, (2017) 40, 1249, at 1273.

⁹⁴ Mol, (2015)., at 154.

⁹⁵ Ibid.

⁹⁶ OECD, *Due Diligence Guidance for Responsible Business Conduct*, 2018, at 49-50.

⁹⁷ Ibid, at 50-51.

⁹⁸ Boersma, at 1271.

⁹⁹ Boersma, at 1272.

national hard law provisions have been and continue to be developed. Disclosure has been shown to be limited in its capacity to identify fully the impacts of corporate and supply chain activities and has not led to reduction of adverse impacts or true accountability or remedies for harms caused. The national due diligence provisions that have been inspired by international principles and guidance promise greater effect as they require companies to make efforts to eradicate or mitigate their negative impacts. The possibility of enforcement sanctions, as is anticipated with the developing child labour law in the Netherlands, may be an important shift. This may also require further refinement to impose liability upon the actor within the supply chain with the most control. A key feature of the emerging due diligence will be the collaboration with stakeholders and campaigners acting on their behalf. If successful, these due diligence developments will be a significant contribution to the goals of sustainable development. Whilst focusing especially on human rights related issues, they will feed into the broader strong sustainability agenda by working towards the mitigation of or eradication of inequality and exploitation and human suffering.